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REPORT OF A STUDY OF CONTROL AGENCY REVENUE FEES

Environmental Protection Agency
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July 2, 1974
Office of Planning and Management
U. S. Environmental Protection Agency

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EXECUTIVE SUMMARY

INTRODUCTION

The Federal Government first provided grants to defray the operating expenses of State and interstate water pollution control agencies in 1957, and State and local air pollution control agencies in 1963. Since then these grants have increased in keeping with the widened Federal role in pollution control, and the imposition of additional Federal requirements on State and local pollution control agencies. During FY 1974, Federal grants, under Section 106 of the Federal Water Pollution Control Act (FWPCA) and Section 105 of the Clean Air Act (CAA), amounted to approximately $90 million, or roughly 37 percent of total control agency expenditures.

In early 1974, EPA agreed with OMB to examine options for encouraging State and local governments to become more self-sufficient in support of their air and water pollution control agencies.

METHODOLOGY

The study focused on the revenues potentially available from fees charged in permitting, inspecting, monitoring, or otherwise regulating air and water pollution, and on the potential problems and reactions likely if Federal control agency grants were phased-out.

The research undertaken included:

- Fact finding visits to 9 States representative of national practice and attitudes (Massachusetts, Connecticut, North Carolina, Mississippi, Michigan, Ohio, Illinois, California, Arizona).
- A review of State constitutions and laws pertinent to fees.
- A comprehensive review of existing control agency practice with regard to fees at both State and local levels.
- A review of recent trends in, and principles governing, the use of fees by government in general, by EPA, and by other Federal regulatory agencies.
- Meetings with control agency officials and persons selected by the "Big 7" associations of State and local elected officials.

FINDINGS

Fees as a Source of Control Agency Revenue

Fees have been levied by pollution control agencies for over twenty years. However, the information we have collected indicates that fee receipts amounted to only three percent of the $240 million in estimated State and local control agency expenditures during FY 1974.

Current use of fees - The use of fees by control agencies varies considerably from State to State. The State of Michigan expects to raise approximately 30 percent (i.e., $2.3 million) of its pollution control agency revenue from fees during FY 74. Fees in all other State and local control agencies are estimated to amount to less than $6 million. In approximately 30 States, no such fees are levied. The situations in the nine States visited by the study team may be summarized as follows:

- The State control agencies in Massachusetts, Connecticut,

Mississippi, North Carolina, and Illinois either collect no fees or only negligible amounts. Massachusetts and Illinois have statutory authority to levy fees, but do not do so. The Mississippi legislature repealed the statutory authority for a permit fee in 1973.

- The State control agencies in Arizona, Ohio, and California raise less than five percent of their total revenues from fees. This is true in California even though the potential for fees has been thoroughly examined over the last 6 or 7 years as a result of encouragement from the Governor's office.

- The local air pollution control agency in Cook County, Illinois, expects to raise about 20 percent (i.e., $250,000) of its FY 74 revenues from a permit fee.

- As mentioned earlier, the State air and water pollution control agencies in Michigan expect to raise approximately $2,300,000, or 30 percent of FY 74 revenues, through air and water "surveillance" fees.

- The local air pollution control agency in Maricopa County, Arizona, expects to raise two-thirds (i.e., $200,000) of its FY 74 revenue through a broad-based permit fee.

Generally, fee receipts are deposited in the general fund of the State or local government involved, with comparable funds being made available to the control agency through appropriations.

Potential for fees - An estimate of the nationwide revenue potential of control agency fees has been developed. Fees could amount to as much as 30 percent of the funding required by State and local control agencies to implement the requirements of the FWPCA and the CAA. It should be noted, however, that these potential revenues are less than the increases over current Section 105 and 106 grant funding State and local governments indicated they would need during testimony before the House Appropriations Committee.

Obstacles to Fees - In the vast majority of States and localities control agencies must have specific statutory authority to levy fees. The largest obstacle to be overcome in obtaining this authority, and raising a significant amount of revenue through such fees, would be the generally negative attitude of State and local officials. These attitudes may be summarized as follows:

- As the benefits of pollution control programs are largely to the general public, these programs should be supported through appropriations from general tax revenues.
- Control agencies should concentrate on controlling pollution and leave the generation of revenues to other government agencies; a fee program may lock an agency into an annual inspection program for the purpose of raising revenue, where a lesser frequency might be acceptable for the purpose of pollution control.
- Fees are just another form of taxation, and a regressive one at that. Further, it costs more to levy and collect fees than taxes.
- Developing an equitable and technically acceptable fee schedule will be a difficult process, especially if the fees are large enough to provide a major source of revenue.
- Agencies financed primarily through fees tend to be less responsive to general purpose governments than those financed by appropriations and grants.

Fees may be attractive when increased appropriations are not available, and the situation is otherwise propitious, as was apparently the case in Michigan and Maricopa County. In any case, officials of both general

purpose government and control agencies regard the source of non-Federal revenue a matter for State or local resolution, and would generally resent Federal intervention in this area.

Implications of Phasing-out Federal Grants

In formulating the Clean Air Act and the Federal Water Pollution Control Act, Congress envisioned and provided for a Federal/State partnership which is unique in many respects. While recognizing the primary responsibilities and rights of the States to prevent and control pollution, it was made quite clear that the Federal Government, specifically EPA, is held accountable should the States fail to perform.

EPA Strategy - In implementing these laws, EPA has worked to encourage the States to carry out their statutory roles, and to enable them to undertake increased responsibility for the attainment of national environmental objectives. This has included the encouragement of strong State and local environmental programs, and the delegation to the States of Federal responsibilities such as the review of plans and specifications related to waste treatment construction grants. The Agency has used the air and water control agency grant programs to support (1) increased State and local staffing levels and competencies; (2) specific program "outputs" which are coordinated with Federal strategies intended to attain statutory goals; and (3) the collection of data for use in planning and implementing national pollution control programs. More broadly, these grants have resulted in a relatively effective Federal/State partnership.

Grantee attitudes - The reactions of State and local officials to the possible phase-out of Federal control agency grants are summarized below:

- The States and localities will not take over Federal responsibilities such as the administration of the construction grant and water permit programs; in addition they will back down from a variety of Federally-required activities such as monitoring, planning, and enforcement if the Federal Government does not pay its "fair share" of their costs.

- Such a move would be seen as a clear shift in the Federal commitment to a Federal/State partnership and in the priority assigned environmental matters by the Federal government; some States and localities fear that as a result their own programs would also be imperiled.

- In most cases, reductions of Federal funding would only slowly be made up by increased State and local appropriations; in some cases, State and local funding may actually be reduced.

- Most State and local governments would not turn to fees; they had re-evaluated the feasibility of fee revenues when the Malek-Train exchange was made public, and decided not to move in this direction.

- The Federal Government should make a clear and convincing statement of intent in order to overcome the current state of uncertainty regarding the future of the grant programs. Any attempt to encourage the use of fees, even as a supplementary source of control agency revenue, would be greeted with skepticism and would continue the current uncertainty.

It is clear that the phase-out of program grants would require increased Federal intervention or program management. As EPA is not likely to have the resources to adequately carry this out, the attainment of statutory environmental goals would be delayed.

OPTIONS AND RECOMMENDATIONS

During the study, four options were identified as ways in which EPA might approach encouraging State and local governments to become more self-sufficient in support of their air and water pollution control agencies through the use of fees:

Option 1 - Phase-out control agency grants, while actively encouraging the use of fees

Option 2 - Continue the grant programs at no less than current levels, while actively encouraging the use of fees

Option 3 - Continue the grant programs at no less than current levels, while providing additional Federal financial incentives for the use of fees

Option 4 - Continue the grant programs at no less than current levels, and undertake no formal encouragement of fees

We recommend Option 4. A phase-out of the existing grant programs will reverse the current trend toward greater State and local responsibility, which would either require a significant increase in Federal staffing or result in a diminution of effort in achieving legislatively mandated environmental goals. The encouragement of air and water pollution control fees will continue the current uncertainity regarding the Federal commitment to the Federal/State partnership envisioned in the Acts.

A number of steps are recommended in the report, however, which should provide greater State and local latitude within the existing grant programs, while still encouraging the assumption of delegated Federal responsibilities and ensuring the attainment of national environmental objectives.

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I. INTRODUCTION

In the advice of allowance for EPA's FY 1975 budget, dated February 4, 1974, the Office of Management and Budget (OMB) included the following directive:

> "Federal grants to State and local pollution control agencies are to be phased out starting in FY '76. Your agency is expected to announce this decision no later than June 30, 1974, and to encourage and assist the affected agencies to become self-sufficient."

The goal of greater self-sufficiency by State and local governments in the area of pollution control has been and will be pursued in many ways. Since its formation in late 1970, the Agency has actively sought and implemented programs intended to encourage the States to carry out their statutory roles, and to enable them to accept increased responsibility for attaining national environmental goals. This has taken many forms including the encouragement of vigorous State environmental legislation, the delegation to interested States of Federal responsibilities such as the review of plans and specifications related to wastewater treatment construction grants, and the use of Federal control agency grants to strengthen State programs which were coordinated with strategies intended to attain Federal statutory goals. As Mr. Train has stated in his letter to Mr. Ash of February 22, 1974, EPA would encourage "State and local governments to become more self-sufficient and, over time, reduce the Federal involvement in this area".

As one step in gaining a better understanding of this area, EPA has conducted a study of how a State or locality might generate the additional funds required by increased self-sufficiency. The study focused on "user charges", or fees charged to public or private organizations in permitting, licensing or otherwise regulating air and water pollution, primarily for the following reasons.

1. Untapped revenue source - Although fees have been used to some degree by pollution control agencies for over twenty years, since the early 70's a few State and local control agencies have successfully turned to fees as a major source of revenue.

2. Attractive revenue source - As discussed in a paper prepared by OMB in late 1973, increased fee revenues in the area of pollution control seem attractive for a variety of reasons. These included 1) economic efficiency (the polluter pays and either accepts reduced profits or passes the cost on to the consumer) and 2) greater public accountability (as a result of charging a fee for a service, both the public agency involved and those paying the fee would give more attention to the value of the service provided).

The study was structured to look positively at the potential use of fees as a method of partially or completely funding State and local pollution control agencies. This approach was necessary to assure the objectivity of the effort.

The primary objective of the study was to identify 1) the obstacles that might stand in the way of the increased use of fees by State and local control agencies, and 2) actions that EPA might take to encourage their use. Since this study included interviews with a number of State and local officials, a second objective was to seek opinions regarding the possible impact of reducing Federal control agency grants as a method of stimulating increased self-sufficiency.

The tasks undertaken during the study may be summarized as follows:

- Relevant information from previous efforts was identified and reviewed. Except for the products of a joint OMB/EPA effort conducted during mid-1973, it was soon apparent that neither EPA headquarters nor the regions knew much about the use of fees by control agencies.

- Visits were scheduled with 9 States in 4 EPA regions to gather as much data as possible on:

  - the attributes of existing successful fee systems,

  - how and why these systems were adopted,

  - why many control agencies are making little, if any, use of fees as a source of revenue, and

  - what the prevailing attitudes towards fees and fiscal self-sufficiency are among pollution control agencies, Governors' offices, State legislatures and others.

- EPA Regional Counsels were asked to review the types of statutory and constitutional constraints on the use of fees at the State levels.

- Recent trends in the use of fees by government in general, by EPA itself and by other Federal regulatory agencies were reviewed.

- A Policy Committee composed of representatives from EPA Headquarters offices and Regions was established to review the plans and products of the study.

- Meetings were held with representatives from State air and water pollution control agencies, and with State and local officials selected by the "Big 7" national associations of State and local elected officials, to discuss the issues.

II. FEES AS A SOURCE OF CONTROL AGENCY REVENUE

GENERAL COMMENTS

The government sector of our economy provides many kinds of goods and services. Certain services such as police and fire protection benefit the public-at-large. Others benefit specific groups or individuals as well as the public-at-large; for example, public health immunization programs benefit both the persons receiving the inoculations and persons with whom the immunized comes into contact. Still other goods and services such as water supply, sewerage, and trash removal directly benefit clearly identifiable members of society. The first category above is typically paid for by general tax revenues. The latter two categories can be funded through user charges, or fees paid by a beneficiary in exchange for a specific good or service; through general tax revenues; or through some combination of the two.

The main difference between a fee and a tax is that payment of a tax is compulsory while the payment of a fee is theoretically and legally voluntary. In reality however, many fees are not voluntary. For example, a person may choose not to obtain a building permit. However, the failure to do so would either prevent him from erecting the building, or place him in violation of the law. Fines and penalties should be distinguished from both taxes and fees as they are levied not to raise revenue, but to encourage compliance with the law.

After World War II (see Table 1) fees and charges became increasingly more important as sources of revenue for State and local governments. While expenditures were rising rapidly, taxpayers resisted a corresponding increase in traditional sources of revenues such as sales and property taxes. Fees and charges were imposed to fund activities where the public perceived that specific groups or individuals might well be asked to pay for the services they received. The data in Table 1 indicates that the percent of total revenue raised from fees and charges reached a plateau in 1967; however, as total revenues were growing rapidly, fee revenues actually increased by 60 percent between 1967 and 1971.

CURRENT USE OF FEES

Fees have been used by pollution control agencies for over twenty years. An article by Arthur C. Stern which appeared in Air Pollution referenced studies published in 1952 and 1956 which indicated that 72 percent of the air pollution control agencies then operating recovered some portion of their operating expenses through fees charged for the review of construction plans, installation inspections or permits, and annual inspections or operating permits. However, the information we have about existing fees (see Appendices C and D) indicate that fee receipts amounted to only three percent of estimated control agency revenues during FY 1974 (i.e., perhaps 8 million in fee receipts compared to approximately $240 million in total Federal and non-Federal revenues). The use of and attitude toward fees as a source of control program funding varies considerably from State to State. While Michigan raises approximately 30 percent of its revenue from fees (and perhaps 30 percent of all fees varied by pollution control agencies),

TABLE 1.

General Revenue of State and Local Governments
Selected Years, 1950-1971

	1950	1955	1960	1965	1967	1969	1970	1971
Total (billions of dollars)	20.9	31.1	50.5	74.0	91.2	114.6	130.8	144.9
Percent of Total:								
From Federal Government	11.9	10.1	13.8	14.9	16.9	16.7	16.7	18.0
From own sources:								
Taxes	76.1	75.6	71.5	69.2	66.9	67.0	66.4	65.5
Property	35.1	34.5	32.5	30.5	28.6	26.8	26.0	26.1
Sales and Gross Receipts	24.6	24.6	23.5	23.1	22.5	23.2	23.2	22.9
Individual Income	3.9	4.0	4.9	5.5	6.4	7.8	8.3	8.2
Other	12.5	12.4	10.7	10.1	9.4	9.3	8.9	8.3
Charges and Miscellaneous *	12.0	14.4	14.7	15.9	16.3	16.3	16.9	16.4

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*Note: Charges and Miscellaneous includes not only fees and charges, but also such revenues as interest earnings and special assessments; the revenues of government operated utilities and liquor stores are not included.

Source: U.S. Bureau of the Census. Statistical Abstract of the U.S., 1973.

agencies in over 30 States are reported not to levy fees at all.

As part of our study, we visited control agencies in nine States and four EPA regions (Massachusetts, Connecticut, North Carolina, Mississippi, Ohio, Michigan, Illinois, Arizona, and California.) Although the data required to ensure that the States visited were completely representative was not available at that time, the subsequent information summarized in Appendices C and D indicates that the situations in these States do illustrate the national range of use and attitudes. The observations of the study teams are summarized briefly below and presented in more detail in Appendix A.

- The State control agencies in Massachusetts, Connecticut, Mississippi, North Carolina, and Illinois either collect no fees or only negligible amounts. The attitudes of control agency and elected officials interviewed in these States was generally "anti-fee". The reasons given for this attitude ranged from philosophical (e.g., fees are an inappropriate source of revenue for a regulatory agency) to pragmatic (e.g., fees would have increased the resistance to a new permit program). Massachusetts and Illinois have statutory authority to levy permit fees, but do not do so. The Mississippi legislature repealed the statutory authority for a permit fee in 1973.

- The State control agencies in Arizona, Ohio, and California raise less than five percent of their total revenues from fees. This is true in California even though the potential for fees has been thoroughly examined as a result of pressure from the Governor's office over the last 6 or 7 years; legislation introduced in each of the last three years to implement a water "surveillance" fee such as that found in Michigan has never made it out of committee. The air permit fee program in Ohio was originally anticipated to raise $2,500,000 annually, but a series of tactical retreats has reduced the potential yield to one-tenth of that. The Arizona agency inherited an air permit fee from its predecessor, but regards it more as a nuisance than as a source of revenue.

- The local air pollution control agency in Cook County, Illinois, expects to raise about 20 percent of its revenues from a permit fee in FY 74. Agency management reports no problems in levying and collecting receipts from the fees, but they would prefer to have been funded by appropriations, if that had been possible, because of the administrative cost of fees.

- The State air and water pollution control agencies in Michigan expect to raise approximately $2,300,000 in FY 74 through air and water "surveillance" fees. These fees are meant to cover the costs of not only issuing permits and variances but of a variety of other "surveillance" activities, such as compliance monitoring and area monitoring. Collections have been approximately 100 percent of billings during the three years of the water fee and were over 90 percent on initial air billings at the time of our visit. The Governor of Michigan has stated that "assessing the cost of surveillance directly against the pollutant dischargers is the most equitable way to finance such programs". However, primarily because of administrative costs, agency management would prefer to have been funded by appropriations, if that had been possible.

- Finally, the local air pollution control agency in Maricopa County, Arizona, expects to raise two-thirds of its revenues through fees in FY 74. The agency charges fees on a wide variety of sources of air pollutants including earth-moving operations and petroleum storage tanks. They credit the fees with providing the only available way to finance what they consider to be a strong air pollution control program. However, agency management has found itself in a real financial box: the cost of providing the existing level of services continue to rise; receipts from the existing fee schedule have apparently leveled-off, and obtaining a revised fee schedule will take at least 12 months; as the program is considered to be self-sufficient, County general fund support is unlikely; and Federal grants are expected to remain at current levels.

The following general observations may be made based on our visits to these agencies.

- Fee receipts are deposited in the State or local general fund in all cases except Maricopa County. Four of the other five agencies that collected fees noted, however, that comparable amounts were made available through appropriations. Both California and Michigan accomplish this through the mechanism of reimbursed appropriations.

- In all cases, the fees are limited by statute to defraying the costs of specific activities, such as permitting. All agencies considered their fees to be a charge for a service or privilege received by an individual, except Michigan where fees are viewed as a revenue source intended to defray the costs of general surveillance activities.

POTENTIAL FOR EXPANSION

As demonstrated by the Michigan State and Maricopa County agencies, fees are potentially a major source of control agency revenue (assuming for the moment that the obstacles discussed in the next section were to be universally overcome). One way of estimating just how important these may be nationwide is presented below.

Criteria for the Use of Fees

Considering the rapid growth of fees as a source of State and local revenue, there is a surprising dearth of information available to the budget officer or program manager who is trying to decide whether or not to levy a fee. We have not been able to find either model State legislation or accepted "rules-of-thumb" in this area. At the Federal level, however, a basic statement of policy on the use of fees is found in Section 483a of Title 31 of the United States code, generally referred to as the "User Charge Act".

While this policy in no way limits the States in exercising their licensing powers, it is similar to the statutory provisions noted in the States visited by the study team. In addition, the criteria to be used in implementing this general policy, which are contained in OMB Circular No. A-25, illustrate the types of limitations on the use of fees which were mentioned by State and local officials.

These criteria for the use of fees may be summarized as follows:

1. The good or service in question primarily benefits identifiable recipients, rather than the public-at-large.

"Where a service (or privilege) provides special benefits to an identifiable recipient above and beyond those which accrue to the public-at-large ...(e.g., receiving a licenses to carry on a specific business,...safety inspections of a craft..., receiving an airman's certificate...) ..., a charge should be imposed to recover the full cost to the Government of rendering that service

...No charge should be made for services when identification of the ultimate beneficiary is obscure, and the service can be primarily considered as benefitting broadly the general public (e.g., licensing of new biological products)."

2. The costs of providing a measurable unit or amount of services can be identified.

"The maximum fee for a special service will be governed by its total cost and not by the value of the service to the recipient. ...The cost computation shall cover the direct and indirect costs to the Federal Government of carrying out the activity including but not limited to:

- Salaries, employee benefits, rent, cost of fee collection, and other directly related costs.
- A proportionate share of the Agency's management and supervisory costs.
- The costs of enforcement research, establishing standards and regulations, to the extent they are determined to be properly chargeable to the activity."

3. The collection of such a fee makes administrative and programmatic sense.

"...the agency may make exceptions to the general policy under such conditions as illustrated below:

- The incremental cost of collecting the fees would be an unduly large part of the receipts from the activity
- The recipient is engaged in a non-profit activity designed for the public safety, health, or welfare.
- Payment of the full fee by a State, local government or non-profit group would not be in the interest of the program."

This is not a comprehensive listing of the types of criteria mentioned in interviews with State and local officials. Very little help is available in determining what portion of a particular government service benefits specific groups or individuals as opposed to the public-at-large. For example, the certification of waste water treatment operators is typically funded partially from fees (i.e., the applicant benefits in that he is allowed to pursue his livelihood) and partially from taxes (i.e., the public benefits from having trained operators). Other criteria include equity (e.g., will the fee impose an undue hardship on some beneficiaries) and side effects (e.g., will applicants for licenses prefer to get out of the business or break the law in lieu of paying the fee). And sometimes Federal laws either forbid user charges (e.g., airport board fees) or require them (e.g., the cost recovery requirements of EPA's construction grant program.) These

criteria can be useful, however, in developing an estimate of the potential revenues that might be raised by control agency fees.

Projections of Control Agency Resource Needs

One of the criteria for the imposition of fees contained in Circular A-25 is that "the maximum fee for a special service will be governed by its total cost and not by the value of the service to the recipient". In order to develop an estimate of the potential for control agency revenues from fees, the best available projections of the level of control agency resources necessary to implement national environmental objectives have been identified. These projections are described below.

Air pollution control - The most authoritative base for projecting the needs of State and local air pollution control agencies are the FY 75 resource estimates contained in the State Implementation Plans (SIP's). An analysis of the tasks involved indicates that the resources required to implement the activities included in the SIP's (and in certain additional activities described below) can be expected to remain approximately level through the remainder of the 70's.

A summary of the resource needs expressed in the SIP's is shown in Table 2 in terms of the man-years of effort required in each of four major functional areas. Some implications regarding potential fee revenues may be drawn from these estimates. If fees sufficient to defray the costs of permit system operations were to be levied, the resulting revenues would amount to perhaps 9 percent of total resource needs. An air surveillance fee similar to the

TABLE 2

AIR POLLUTION CONTROL AGENCIES
ESTIMATED NEEDS OF MAJOR FUNCTIONAL AREAS
AS A PERCENT OF SIP FY 75 RESOURCE REQUIREMENTS

	Man-years[1/] of effort	Percent of Total
Management		
1. Policy and administration	1076	12.5%
2. Training	491	5.7
3. Liaison and community relations	496	5.7
Engineering		
4. Permit system operations	814	9.4
5. Source registration and emissions estimates	585	6.8
6. Engineering reports & miscellaneous	461	5.3
Enforcement		
7. Inspections and compliance monitoring	2166	25.1
8. Complaint handling and field patrol	919	10.6
Technical Services		
9. Ambient air quality monitoring	447	5.2
10. Laboratory operations	756	8.8
11. Special projects	419	4.9
TOTALS	8630	100.0%

1/ Source: SIP FY 75 resource estimates; clerical and data processing support man-years have been prorated over related activities

one levied in Michigan might raise revenues amounting to 52 percent of total resource needs, as follows:

control agency activity	percent of total needs
Permit system operations	9.4%
Source identification and registration (2/3 of item #5)	4.6
Inspections and compliance monitoring	25.1
Complaint handling and field patrol	10.6
Laboratory support (related to source registration)	2.4
TOTAL	52.1%

In practice, the potential for revenue from such a fee program would be lower for a variety of reasons, including 1) the portion of these costs directly related to enforcement actions would probably not be supported through fees; and 2) tax-supported, tax-exempted and small sources are generally exempted from paying such fees (as in Maricopa County and Michigan). Although no documented basis for estimating the impact of these exclusions or exemptions is available, it would appear that an air surveillance fee program might amount to 30 to 40 percent of the costs represented by the initial SIP resource estimates. As the remaining activities (e.g., policy and administration, ambient air quality monitoring, and special projects or reports)would probably not be recoverable through fees (i.e., according to criteria #1 of OMB Circular A-25), this may represent the maximum portion of air pollution control agency costs that could be recovered through fees.

Th: initial SIP resource estimates were compiled by the States during Y 72. Subsequent revisions have become necessary due to increas d experience in carrying out the activities included in the SIP's, nd due to additional activities that have been imposed upon th control agencies. In mid FY 74, EPA Regional Offices were asked t obtain new estimates of FY 75 resource requirements from the Sta es. The resulting, revised estimate is 9484 man years. 1/ The est nated man years required by the activities included in the SIP's i now 7,813, a reduction of over 9 percent from initial estimat .. Additional resource needs of 1,671 man years were identif ed, primarily in the areas of transportation controls, indirec source controls, non-degradation controls, and related monitor: ng and evaluation activities. Based on what is known of the nat re of these new activities, the estimate of potential fee revenue: remains at 30 to 40 percent of total resource costs. In FY 74, : uch fees amounted to an estimated 5 percent of total air pollutic n control agency funding.

Wa er pollution control - Projections of the resource needs of State w. ter pollution programs are more tentative than those in air due to : e lack of an authoritative base such as the SIP's. For the purpose f this study, an estimate of expenditures in eleven key

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1/ Sou ce: St ate Air Pollution Implementation Plan Progress Re port, June 30 to December 31, 1973; EPA-450/2-74-004, April, 1974.

program areas during the period FY 1976-83 has been prepared by EPA headquarters staff (see estimating assumptions in Table 4).

These estimates are not meant to be predictive of the total costs of implementing PL 92-500, nor of the total expenditures by State water pollution control agencies (States perform a variety of additional activities over and above those needed to comply with Federal requirements). Additional reservations about the validity of the estimates include:

- No provision is made for expenditures for non-point source control activities, which could amount to $25 million annually as early as FY 1975.
- It has been assumed that all States will assume NPDES authority, but construction grant reviews will be certified to less than 40 of the States.
- No good bases for projecting training and enforcement activities exist; these costs are included at FY 1974 levels.
- Inflation has not been considered; costs are presented in current (FY 74) dollars.

Nevertheless, even these tentative and partial estimates are useful in gaining some quantitative perspective on the potential for fee revenues.

In Table 3, the percent of total costs represented by each of the key program areas is summarized, and compared with comparable expenditures during FY 74. The projections reflect the following:

TABLE 3

ESTIMATED COSTS OF KEY PROGRAM AREAS
AS A PERCENT OF TOTAL STATE COSTS

	FY 74[1]		FY 76-83[2]	
Planning				
WQ Standards	--		2	
303 (e)	--	16.4%	7	9%
Monitoring				
Compliance	--		30	
WQ Network	--		3	
Intensive Surveys	--	22.2	3	36
Permits		26.3		20
Enforcement		10.4		11
Municipal Facilities				
Construction Grants	--		6	
O&M Surveys	--	12.4	6	12
Training		1.4		1
Administration		11.0		11
Totals		100.0%		100%

1/ Source: FY 74 State program budgets

2/ From Table 4; again no provision has been made for the costs of non-point control activities, and the costs of enforcement and training are included only at FY 74 levels

- Revisions of WQ Standards are required every 3 years, and new Federal criteria are being developed for many constituents of pollution. These changes in WQ standards and new knowledge about levels of controls needed on both point and non-point sources will require the revision of 303(e) basin plans.

- In-stream water quality monitoring efforts will be increased, both in development of a national network of some 10,000 stations, and in the conduct of intensive water quality surveys.

- Once the first round of permits is issued, activity in this program element will fall off. However, initial short term permits will have to be renewed, revisions of some permits will be needed, and new sources will require permits. Finally, another peak in permitting will occur from 1979-81 as most first round permits expire and new standards are applied. As permit issuance temporarily declines in FY 77-78, compliance monitoring will increase.

- Current emphasis on construction of treatment works will continue. Once in place, the facilities coming on line will stimulate an increased need for operations and maintenance assistance.

- Finally, in-direct administrative costs will continue at approximately 11 percent of total costs and, as mentioned above, enforcement and training activities are assumed to continue at FY 74 levels.

Some implications regarding potential fee revenues may be drawn from these estimates. If fees sufficient to defray the costs of issuing permits were to be levied, the resulting revenues would amount to perhaps 20 percent of total costs. However, perhaps 40 to 50 percent of these permits will be issued to publicly-owned treatment works which are traditionally exempt from such fees. In addition, as NPDES permits are issued with a 5-year term the number of permits issued in any one year will fluctuate, as will the resulting revenues.

A more stable and substantial revenue base is provided by a water surveillance fee. In Michigan, such a fee system is meant to defray costs associated with permits, compliance monitoring, and area monitoring. If fees sufficient to defray these costs were to be levied, the resulting revenues would amount to perhaps 51 percent of total costs, as follows:

program area	% of costs
Compliance monitoring	30%
Area monitoring (part of WQ network costs)	1
Permits	20
TOTAL	51%

However, again perhaps 40 to 50 percent of these costs can be attributed to publicly-owned treatment works and would probably be exempted from paying fees.

Planning, direct enforcement, in-direct administration, municipal facilities and the remaining monitoring activities could probably not be supported by fees. Revenues from training fees would be relatively insignificant. Hence, it may be concluded that fees could potentially defray approximately 25 percent of total costs. In FY 74 such fees amounted to an estimated two percent of total water pollution control agency funding.

Table 4

ESTIMATING ASSUMPTIONS

	Program Area	Assumptions	Costs per Output Unit	Total FY 76-83 Costs ($000)	Percent of Total Costs
1.	Water Quality (WQ) Standards	Each State must revise its WQ Standards every 3 years. (56 States x $90,000)	$ 5,040,000 per revision	$ 15,120	2%
2.	303(e) Basin Planning	600 plan revisions due to changes in WQ standards and new knowledge about needed control.	100,000 per plan	60,000	7
3.	WQ Monitoring Network*	Six samples per annum in each of 10,000 monitoring stations.	50 per sample	24,000	3
4.	Intensive WQ Surveys	Three surveys per annum in each State (1344 surveys over the period).	22,500 per survey	30,240	3
5.	Permits	180,000 permits to be issued over the period.	1,000 per permit	180,000	20
6.	Compliance Monitoring	167,000 plant inspections over the period.	1,600 per inspection	277,800	30
7.	Enforcement	FY 74 expenditure level to continue	12,100,000 per annum	96,800	11
8.	Construction Grant Projects	463 man years per annum to administer average of 3,000 projects	6,945,000 per annum	55,560	6
9.	O & M Surveys	35,000 inspections per annum at 3 man day per inspection.	200 per inspection	56,000	6
10.	Training	FY 74 expenditure level to continue.	1,600,000 per annum	$ 12,800	1
11.	Administration	Twelve percent of program costs (average in recent years).	-----	97,000	11
			TOTAL COSTS	$905.320	100%

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Tentative Conclusions

If the States and localities were to follow the criteria in OMB Circular A-25, we can draw the following tentative conclusions:

- If fees were to be levied nationwide to support permit systems only, the resulting revenues could amount to 9 percent of total air control agency resource needs (20 percent for water).

- If fees were to be levied for a wider range of "surveillance" activities (as in Michigan), resulting revenues could amount to as much as 35 percent of air control agency resource needs (25 percent for water).

These two cases may well represent the range of potential fee revenues that exist before considering the obstacles described in the next section.[1/] The use of fees to defray the cost of issuing permits would probably fall well within the first criteria described earlier in this section regarding the nature of benefits received. On the other hand, whether or not the surveillance activities included in the broader definition are rightly classified as benefits to "individuals" or the "public-at-large" is a question that could occupy many hours of philosophical discussion and on which the opinions of State and local officials varied greatly.

Whether or not these potential fee revenues would be available to replace Federal grants (which provided 37 percent of estimated total State and local control agency funding during FY 74) is

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1/ It should be noted that no attempt has been made to determine if the level of fees (i.e., the range of fees paid by individual sources) required to generate this amount of revenue in a specific State would be feasible or not.

question ble. The estimated FY 75 expenditures associated with the revised stimate of air pollution control agency needs of 9484 man years am unt to approximately $189 million, an increase of $75 million ver the approximately $114 million expended by such agencies during FY 73. The increase alone is equal to 40 percent of these total expenditures, and is at least as much as the estimated potentia. revenue from fees. A similar need for increased funding of water pollution control agencies has been discussed. In testimony before t e House Appropriations Committee, officials of the State water po lution control agencies have called for a $60 million increase in Feder l program grants to fund the requirements of the Federal Water Po lution Control Act. If such an increase were forthcoming, it would equal 34 percent of what would then be total State water pollutio. control expenditures; this is more than the estimated potential revenue from fees.

Reg rdless of whether they would ever be sufficient to replace Federal rants, it would seem reasonable to conclude that if fees were to e actively pursued in all States, that perhaps as much as 30 pe cent of total resource needs might be raised. This compares to an estimate of approximately 3 percent of total revenue provided by fees in FY 74. The obstacles to attaining this potential are disc ssed in the next section.

OBSTACLES TO EXPANSION

There are a variety of obstacles which must be overcome in order to attain the potential fee revenues discussed above. These obstacles may be classified as follows:

- Statutory constraints
- Political climate
- Control agency attitudes

Each of these areas is discussed below based upon our discussions with State and local officials.

Statutory Constraints

EPA Regional Counsels were asked to review existing statutory and constitutional constraints on the use of fees by State air and water pollution control agencies. The review was kept as brief as possible in order to get a nationwide picture of the dimensions of such constraints in a short time period. A summary of information about the 47 States that has been reported to date is shown in Table 3. Based on these results the following observations may be made:

- There are few constitutional or statutory prohibitions on the levying of such fees by control agencies (i.e., specific language that applies to the control agencies themselves or more generally to State agencies as a whole). However, authority to levy such fees may not be inferred from the lack of such prohibitions. The responses indicate that control agencies consider themselves legally prohibited from levying fees except when they are specifically authorized to do so by State statute. This is in contrast to the Federal

Table 5

Summary of Statutory Constraints

QUESTIONS	REPLIES
1. For each State please answer the following:	
(a) Does the State's constitution, explicitly or by judicial or attorney general interpretation, prohibit collection of fees by the State control agency? (yes or no)	47 no 4 unknown
(b) If answer to (1) is no, does State law explicitly or by judicial or attorney general interpretation prohibit collection of fees? (yes or no)	45 no 2 yes
2. For each State for which there are no answers to both 1(a) and 1(b), (i.e., fees are not prohibited), please answer the following (whether or not fees are actually collected):	
(a) Would all or a substantial portion of such fee receipts be directly available to the control agency? (yes or no)	31 no 7 yes 7 unknown
(b) If the answer to 2(a) is no, please specify:	
(1) Whether the limitation on use is (constitution, State law, or administrative rule).	6 constitution 20 State law 2 admin. rules 3 unknown
(2) Where the fee receipts go (e.g., general fund).	31 general fund
(3) Whether a comparable amount of funds is indirectly made available to the control agency by legislative appropriations? (yes or no)	14 yes 10 no 7 unknown
(c) Are the fees so limited in amount or coverage that the receipts would not constitute a significant source of control agency revenue? (yes or no)	28 yes 8 no 9 unknown

case where, unless prohibited by legislation, agencies can levy charges that meet the criteria set forth in OMB Circular No. A-25.

- Of the 45 States where fees are not prohibited, there are only 7 in which fees would be directly available to the control agencies, presumably through a "revolving" fund. In 31 States existing statutes or accepted practice dictate that receipts would be deposited in the general fund. However, in at least 14 of these 31 States the legislature would customarily make comparable amounts available through appropriations.

- Of the 45 States where fees are not prohibited, 28 of 36 answering the question do not consider that the fees they would collect could be a significant source of control agency revenue. However, it is not clear whether the limitation on fee amount would be statutory.

In summary, there are generally three types of statutory constraints that must be overcome before fees can provide a major source of control agency revenue. There must be specific statutory authority to levy fees; funds in amounts comparable to fee receipts must be made available to the control agency, perhaps through reimbursed appropriations as in Michigan or California; and finally the fees must not be so limited in amount, as they are in the case of Ohio's water permit fees, that they would not yield significant amounts of revenue. Whether these obstacles will be overcome will primarily depend upon the political climate of the State involved, and upon the attitudes of control agency officials.

Political Climate

In t e States and localities we visited, it was apparent that fees are uthorized and implemented in a highly political, and visible, rena. Statutory authority to levy increased fees is obtained hrough the legislative process. Public hearings regarding the propo ed fee schedule may then be required by law or by practical considera ions. The schedule typically must then be approved by the Board or Commission responsible for overseeing the pollution control a ency's activities. Finally, the fee schedule may be reviewed y the legislative body itself; formally, as in Michigan or less f rmally as in Ohio.

At e ch of these steps, the proponents of fee schedules must overcome he objections of the special interest groups involved, or perhaps more fundamental attitudes about how government is to be financed. It is almost impossible to predict the outcome of such an effort in any one State, but the following example illustrates the wide ange of possible outcomes. During 1970 and 1971, the State of ichigan adopted and implemented a water surveillance fee program t at currently raises revenues amounting to 25 percent of the budge of the water pollution control agency. The legislation was suppo ted by the State Chamber of Commerce and passed both houses of the State legislature by a nearly unanimous vote. Similar legislation in California has had a very different fate. Partially in response to pressure from the Governor's office, the California

Water Resource Board commissioned a study on fees. The study recommended the adoption of a water surveillance fee similar to the one levied in Michigan. Legislation to enact such a fee was drafted and submitted in 1972, 1973 and 1974; the bills have yet to make it out of committee. The only support outside of the California WRB came from the Sierra Club.

It is possible that the Michigan surveillance fee program is unique in the nation because it was the product of unique political circumstances. The mercury scare in 1969 brought public pressure to bear on both government and industry; a Truth in Pollution Bill was drafted to require reporting by industry and authorize the surveillance fee program to pay for the increased costs; industry, feeling the heat of the peak of the environmental movement and seeking the best available package of legislation, agreed to a fee with statutory constraints on use and amount.

Based on our discussions with State and local officials, the following types of attitudes have been identified:

- The main attraction of fees seems to be that they may provide a source of revenue when increased appropriations are unavailable, as was apparently the case in Michigan and in Maricopa County.

- Although there is general agreement on the principle that the "polluter" should pay for the cost of installing pollution control equipment, there is little agreement on the principle that the polluter should also pay for governmental pollution control programs. The general attitude seems to be that the benefits of pollution control

programs are largely to the general public; hence the general public should support these programs through appropriations from general tax revenues.

- A related concern is that it is inappropriate to charge a fee to cover the costs of a regulatory agency; it opens the door to increased influence by the person being regulated. The fear was expressed that fee-supported pollution control agencies would be less responsive to State and local elected officials than is now the case.

- It is anticipated that developing equitable and technically acceptable fee schedules will be a difficult process, especially if the fees are high enough to provide a major source of revenue.

- Several stated that control agencies should concentrate on controlling pollution and leave the generation of revenues to other government agencies; a fee program may lock an agency into an annual inspection program, where a lower frequency would be acceptable, for the purpose of raising revenue.

- Finally, it is believed fees are just another form of taxation, and a regressive one at that; furthermore, it is thought that it costs more to levy and collect $1 in fees than $1 in taxes.

One final observation to make is that this process can take a long time to complete. In Michigan, substantive discussions of a water surveillance fee began in late 1969, enabling legislation was passed in late 1970, the fee schedule was approved by the Joint Rules Committee in the late summer of 1971, and initial receipts were received in February of 1972. The total elapsed time was just over two years. It can take longer; the total elapsed time between initial substantive discussions of the Michigan air surveillance fee and initial receipts was just over four years.

Control Agency Attitudes

The determination to overcome the types of obstacles described so far must in most cases come from State and local control agency officials. However, the attitudes toward fees among control agency officials are generally negative. In many cases this may primarily be a reflection of political realities. Further, agencies currently charging fees report that some of the problems anticipated by those that don't collect fees are unfounded:

- Industry, especially big industry, generally pays its bill without complaint
- The influence of the "polluter" has not been increased as a result of levying fees
- The cost of administering a fee system, to the extent that such information is available from their accounting systems, is approximately 10 percent of fee receipts (but depends on the amount of fees raised).

There remain a number of areas on which there was general agreement among the control agency officials interviewed:

- The administration of a fee program will require staff time and attention, which constitutes non-productive effort insofar as pollution control is concerned.
- Fees generally lack the flexibility and dependability of appropriations; once enacted, fee schedules are difficult to change.
- Tax-supported and tax-exempt facilities are generally exempted from paying fees for political reasons; small sources are exempted when collection costs become prohibitive. These exemptions impair the rationale for charging fees on the remaining sources.

- Resulting fee schedules are bound to vary from one agency to another, as they do among the 19 local air pollution control agencies in California. This non-uniformity will result in further economic incentives for the location of industry in areas with less demanding pollution control programs.

For reasons such as these, control agency officials were nearly unanimous in preferring to rely on appropriations rather than fees.

III. IMPLICATIONS OF REDUCING FEDERAL GRANTS

In discussing the implications of reducing Federal control agency grants we have addressed: 1) the roles of Federal and State/local governments as set forth in the Clean Air Act and the Federal Water Pollution Control Act; 2) the role of EPA's air and water program grants in administering these programs; 3) the attitudes of grantees toward possible grant reductions, and 4) implications for the attainment of national environmental objectives.

STATUTORY ROLES

Section 101(b) of the Federal Water Pollution Control Act, (FWPCA), as amended, states: "It is the policy of the Congress to recognize preserve and protect the primary responsibilities and rights of States to prevent, reduce and eliminate pollution, to plan the development and use (including restoration, preservation, and enhancement) of and and water resources, and to consult with the Administrator in the exercise of his authority under this Act." The role of the States in water pollution control is further specified throughout the FWPCA Major resource requirements are inherent in carrying out such activities as water quality monitoring (§ 106,305), water quality standard development (§ 303), basin planning (§ 303), permit issuance and enforcement (§ 402,309), and compliance monitoring (§ 308).

While it re-emphasized the primary role to be played by the States, Congress made it quite clear that the Federal Government, specifically EPA, is responsible and will be held accountable should the States fail to perform in any of the broad range of activities called for by the FWPCA. For example, in some combination of Federal and State efforts, perhaps 140,000 permits must be issued, renewed, or revised by 1983 under the National Pollutant Discharge Elimination

System (NPDES). Should a State elect not to issue permits, or not have an approved NPDES program, the law provides that EPA shall issue the necessary permits (§ 404).

To further insure an effective Federal/State partnership in the national effort to control and abate water pollution, Congress provided for "Federal technical services and financial aid to State and interstate agencies and municipalities in connection with the prevention, reduction and elimination of pollution".

Similarily, Section 101(a) of the Clean Air Act (CAA), as amended, states: "That the prevention and control of air pollution at its source is the primary responsibility of States and local governments, and that federal financial assistance and leadership is essential for the development of cooperative Federal, State, regional and local programs to achieve the prevention and control of air pollution". The CAA further specifies (§ 110) that through the development of State Implementation Plans (SIP's), the States are required to establish regulations and carry out enforcement and monitoring activities which will ensure the attainment of National Ambient Air Quality Standards. The CAA also allows EPA to delegate to the States the control of hazardous air pollutants (§ 112) and new sources (§ 111). Court decisions have imposed additional requirements on the States in the area of transportation controls, indirect source controls, and significant deterioration activities.

As in the case of the FWPCA, EPA is responsible and will be held accountable should the States fail to perform in these activities. For example, as of December 31, 1973, only fourteen SIP's had been fully approved as submitted by the States. EPA has had to promulgate corrective regulations in the remaining forty-one States and territories.

EPA STRATEGY

In implementing these laws, EPA has actively sought and implemented programs intended to encourage the States to voluntarily carry out their statutory roles and to accept increased responsibility for the attainment of national environmental objectives. This has taken many forms including the encouragement of vigorous State environmental legislation, and the delegation to the States of Federal responsibilities such as the review of plans and specifications related to waste water treatment construction grants. But perhaps most important is the fact that EPA has chosen to use the air (§ 105) and water (§ 106) grant programs to strengthen State programs and support strategies intended to attain statutory goals.

While adequate staffing is not the sole factor in attaining environmental goals (adequate data, planning and political willingness are others , it is clearly a necessary precondition. For this reason, during the early stages of the air and water grant programs, the Federal Government's primary objective for the grants was the stimulation of a rapid increase in staffing levels and competencies. The States and localities have generally responsed by contributing a higher non-Federal share of expenditures than required by Federal legislation. For example, in FY 72 and FY 73 the States and localities contributed approximately $1.28 for every $1.00 in Federal air pollution control grants and $2.92 for every $1.00 in Federal water pollution control agency grants.

Not only have program grants been successfully used to build State and local capabilities, but they are also being used as the primary mechanism for coordinating State/local and Federal pollution control activities. This use of the grants has received increasing

emphasis since the Agency-wide Management by Objectives system (MBO) was instituted in the fall of 1972. Specifically, this is a process whereby operating objectives consistent with statutory goals are set down by EPA in "strategy papers". Each Spring these objectives are translated into specific "outputs", which are to be met through the combined efforts of Federal, State, and local agencies during the upcoming fiscal year. Specific output levels are then negotiated by EPA Regional Offices and the States through the control agency program grant application and award process.

The delegation of the NPDES program to the States is a good example of this use of program grants to foster cooperative actions. As mentioned previously, the FWPCA requires that all NPDES permits be issued by a specified date, and provides for the delegation of the program to the States. Each State's FY 74 grant was structured to provide (1) a base amount to continue Federal assistance on ongoing programs, and (2) an incentive amount targeted at key program elements for the coming year. In FY 74, one of the key program elements was the development of a State's NPDES program.

A State which elected not to operate under NPDES was generally not eligible to receive the incentive money earmarked for permitting. A State that wanted to adopt NPDES, but which was having trouble getting the necessary statutory authority or working out an approved program, could qualify for incentive money in amounts which depended on their level of effort. The States in Region VIII, for example, are expected to draft 60 percent of the permits unissued as of June 30, 1974. In at least one case, the EPA Regional Administrator increased the amount of incentive money for which the State could qualify in order to get the State to reconsider its initial refusal

to have anything to do with NPDES. To the extent that States do not assume NPDES authority, of course, EPA must commit its own resources in order to achieve the statutory deadlines.

In some areas EPA has had to actively pursue programs intended to force the States to assume their statutory roles. For example, many State Implementation Plans were written by contractors, hired by EPA when States were unable to staff-up in time to do so, in order to prevent strictly EPA promulgation of the plans. Implementation of the SIP's, and their revision as necessary, must be carried out by the States or they face (a) the threat of mandatory Federal intervention, (b) Federal promulgation of regulations, and/or (c) a reduction in grant funds.

A third use of the grants is that of contracting for, or buying, data for use in planning and implementing national pollution control programs. Examples are the air pollutant emissions data contained in the National Emission Data Survey (NEDS) and the air quality data contained in SAROAD. While this data is important in the determination of national trends in environmental improvement for review by Congress, other agencies and the public, it is often perceived as having marginal use by the State or local agency which must collect it. Hence, EPA has often tied grant awards to the submission of such data. In States where this has been unsuccessful, EPA has hired outside contracts to collect and compile the NEDS data base.

So far, we have talked about the grants being used to support fairly specific "things" (i.e., resources, program outputs, and data). But perhaps more important is the type of broad support reflected in discussions during the visit of our study team to the North Carolina

e control agency.

" In North Carolina, Federal grants gain the State's support in responding to Federal time schedules and priorities. The current [State] agency attitude is that this is a positive way to encourage the carrying out of Federal requirements and create a favorable climate for an effective Federal-State partnership. If grants are reduced, [State] agency personnel felt the response of the State legislature would be to let the Federal government do the job themselves."

GRANTEE ATTITUDES

The following discussion of grantee attitudes is based primarily on our discussions with State and local control agency officials and persons selected by the "Big 7" national associations of State and local elected officials. In addition, EPA has recently received a number of letters regarding the possible impact of grant reductions from State, territorial, and local governments. These letters were sent in response to the publicity concerning the exchange between Mr. Malek and Mr. Train on this matter in February, 1974, and to a subsequent letter of explanation sent by Mr. Train to all the governors.

All but one of these sources strongly urged the continuation of a long-term Federal financial commitment to support State and local pollution control efforts. The one exception was a letter from the territory of American Samoa which indicated that they are planning to become financially self-supporting in FY 76. The most positive statement regarding the prospects of State self-sufficiency was from the Governor of the State of Maine:

> " I might agree with you that it is wise to look ahead and explore ways that the States might become completely self-sufficient in controlling their water pollution problems, but I feel strongly that any cut-back in program funds should not be considered until the States are well along in achieving the goals of the 1972 Amendments."

The major reactions to the possible reduction of Federal control agency grants are summarized below:

- <u>If grants are phased-out, we can expect that a variety of activities currently required by the Federal government will not be carried out</u>.

  Virtually all States consider EPA's program grants as a "quid pro quo" for their implementation of Federal requirements; less grants, less implementation; no grants, no guaranteed implementation. It was indi-

cated that some priorities, most time schedules, and certain activities prescribed in Federal air and water statutes are being implemented by the States only because of control agency grants. Activities that were mentioned included air and water monitoring, basin planning, air compliance schedules, NPDES permits, enforcement activities and transportation controls. State funds would instead be used for State and local priorities. The governor of Delaware stated: " ... the States cannot be expected to pay the necessary expenses required by the Federal Acts and particularly the various regulations which we were not party to." A second governor warned that "withdrawal of Federal funding in all likelihood will collapse these Federal programs, and waste the returns of Federal investment over the past several years." It is anticipated that this reaction would lead to increased Federal intervention, and a corresponding increase in friction between the States and localities and the Federal Government.

- Such a move would be seen as a clear shift in the Federal commitment to a Federal/State partnership and in the priority assigned environmental matters by the Federal government, particularly coming so close on the heels of the recent energy crises.

This shift in priorities might be picked up by State and local elected officials, leading to the reduction in non-Federal funds concurrently with the loss of Federal funds. Six of the 12 letters received from State governors explained that programs initiated and funded by the States themselves would inevitably fail without continued Federal funds for Federally-mandated programs. Each of the 4 local governments writing letters indicated that local pollution control efforts would be crippled by the loss of Federal assistance. Federal funds allow the States to assist local governments in their pollution control efforts. Without continued Federal support, they anticipate this balance would be upset. One governor noted that the threatened Federal phase-out "almost makes a mockery out of the cooperation among the Federal, State, and local governments so strongly stressed in both the Clean Air Act Amendments of 1970 and the Federal Water Pollution Control Act Amendments of 1972".

- The elimination or phase-out of control agency grants would, in a typical State, result in an initial cut back in program funding for such reasons as:
  - a hesitancy to increase State and local revenues,
  - the competition of other programs for these limited revenues,
  - the recent history of rapid growth in State and local pollution control budgets as being an adequate response, "so let the other agencies have their turn", and

- the diminution of public enthusiasm for environmental issues, with an accompanying loss of aggressive support for budget increases.

It is possible that some States will not attempt to make up this initial loss of grant income. On the other hand a few States might be able to restore lost grant income within three to five years.

On the basis of the foregoing, any significant reduction or phase out of EPA control agency grants will result in lost momentum unless EPA can pick up the slack with its own activities, which would require increased Federal staffing and funding.

- More generally such a move would be seen as a retreat from broad Federal goals, causing major reduction in Federal creditability.

Both the FWPCA and CAA were passed by Congress by large majorities; the grants have been steadily increasing for a number of years, developing expectations of continued program growth. Now, directly on the heels of a 100 percent increase in water program grants during FY 74, comes a directive to phase-out the grant program. Seven of the 12 letters received from State governors warned about uncertainities regarding Federal funding commitments in such terms as "will lead to erosion of State confidence to voluntarily follow leadership if this ... leads eventually to a quick Federal cut-back in financial support."

- If grants were to be phased out, most State and local governments would not turn to fees.

Most of the organizations interviewed had evaluated the feasibility of increased fee revenues when the Malek-Train exchange was made public, and decided not to move in this direction. There was some question as to whether an EPA effort to disseminate information about fees would be worthwhile. Only one letter, from the Governor of Ohio, specifically discussed the potential of fees as a source of control agency revenue, and he cited their recent problems with levying fees for air pollution control permits.

- The Federal government should make a clear and convincing statement of intent in order to overcome the current state of uncertainty regarding the future of the grant program, which resulted from the Malek-Train exchange.

If the Federal government intends to phase-out control agency grants in the foreseeable future, it should announce this as soon as possible in order that the States and localities can realistically plan for the

future. There was general agreement that any attempt by EPA to encourage the use of fees, even as a supplementary source of control agency revenue, would be greeted with skepticism and would continue the current uncertainty about the future of Federal grants.

IMPLICATIONS FOR NATIONAL GOALS

It is not possible to comprehensively assess the nationwide impact on environmental objectives of a grant cut-back in a study of this size and time-frame; however, sufficient data have been gathered during our study to support certain generalizations. Two typical responses to major grant reductions are discussed below.

In the first case there would be a severe reduction in the level of activities carried out in certain States. This would result from a current high level of dependence on Federal support and an unwillingness by the State or localities to either increase appropriations or impose fees. The following examples are illustrative of this case:

- In Mississippi (71% Federal support of total air and water program) EPA interviewers were told that the State would not attempt to bring the program back up to the current levels if Federal funds were cut; instead, it was indicated that the State would delay the implementation of environmental programs (ten years in the case of bringing water pollutant dischargers into compliance) and curtail or eliminate some "Federal" activities, such as reporting ambient trend and enforcement data.

- In North Carolina (55% Federal support of total air and water program) officials indicated that there would be an initial cut-back in their program with a corresponding lag in the attainment of environmental goals, particularly with regard to the deadlines in Federal legislation; 10 years was given as the time required to rebuild the program to the current level, most likely through increased appropriations.

- Federal grants to four local air pollution control agencies in Texas were terminated in FY 74. Three of these agencies subsequently ceased to function and the fourth is currently operating at 15 percent of its former level. Although these agencies were primarily concerned with local problems, such as odors and public nuisances, the disappearance of such efforts may reduce overall support of air pollution control efforts in the State.

The consequences in States such as these would be increased Federal management of the pollution control programs.

The second case would involve a smaller cut-back in total effort, probably through increased appropriations. An example of this case is:

- In California (19% Federal support of total air and water program) officials indicated there might be a small reduction in staff as a result of a grant cut-back. Air Resources Board officials were emphatic that efforts which would be reduced in the event of a cut-back would be those considered to be Federally required. In water it was indicated that the State might make up the difference through increased appropriations; no discussion of what change in priorities would result from this was made.

The result in these and similar States is that what are seen as "Federal requirements" -- particularly "new" air pollution control requirements such as transportation controls and maintenance of air quality, and water permitting and compliance monitoring -- would not be carried out or would be carried out at a reduced level by the State. The attitude prevails that the Federal government has an obligation to support these State activities, and that EPA is still ultimately responsible for their completion. Even in this second case, grant reductions would result in increased EPA intervention in these areas, and/or a delay in the attainment of national statutory goals.

In summary, it is clear that the phase-out of program grants would require increased Federal intervention or program management. As EPA is not likely to have the resources to adequately carry this out, the attainment of statutory environmental goals would at least be delayed.

IV. OPTIONS FOR EPA ACTION

Based on the findings of our study, four options have been identified as ways in which EPA might approach encouraging States and local governments to become more self-sufficient in support of their air and water pollution control agencies through the use of fees

Option 1 - Phase-out control agency grants, while actively encouraging the use of fees

Option 2 - Continue the grant programs at no less than current levels, while actively encouraging the use of fees

Option 3 - Continue the grant programs at no less than current levels, while providing additional Federal financial incentives for the use of fees

Option 4 - Continue the grant programs at no less than current levels, and undertake no formal encouragement of fees.

Each of these options is discussed on the following pages. A fifth option, the establishment of Federal fees which the States could be delegated the authority to collect, was examined and dropped for a variety of legal and technical problems.

OPTION 1 - GRANT PHASE-OUT

Under this option, EPA would: 1) announce at an early date that Federal grants are to be phased-out over a three to five-year period and 2) undertake a program of encouraging the use of fees as a replacement for Federal grants.

The arguments for this option may be stated as follows:

- Congress has found that the responsibility for preventing and controlling pollution rests primarily with the States, and it may be appropriate that, following several years of major Federal funding, the States should become more self-sufficient.

- The States and localities would prefer to know, as soon as possible, if the Federal Government definitely intends to phase-out control agency grants in the foreseeable future.

- Preliminary analysis indicates that fees could potentially amount to as much as 30 percent of the total funding required by State and local pollution control agencies to implement Federal requirements, compared to the perhaps 3 percent of control agency revenues raised by fees during FY 74.

- An adequate level of State and local resources will be one of the key determinants in the successful attainment of the Nation's environmental goals; ensuring this is important enough to warrant substantial attention and effort by EPA management and staff.

Arguments against this course of action include:

- The phase-out would be taken as a signal of reduced Federal commitment to an effective Federal/State partnership, and a reduced Federal priority for environmental protection.

- Control agency funding would drop in the short term to at least the current non-Federal level; non-Federal funds may also be cut in individual States; it would take years to rebuild State and local programs to current levels.

- EPA would lose a 'quid pro quo" - Federally-required activities (e.g., monitoring, planning, enforcement) would be curtailed; the States would be unwilling to have programs such as NPDES permits delegated to them; and increased EPA intervention and resources would be required if statutory deadlines are not to be ignored.

- Further delays in attaining statutory goals would result.

- Phase-out of control agency grants would cause a dramatic shift of emphasis from State and local programs to Federal programs, effectively destroying the current partnership which is aimed at shifting responsibilities to the States and localities.

- The source of non-Federal funding is considered to be a State/local matter and these general purpose governments may resent substantial EPA intervention with regard to the method of revenue collection.

- Finally, State and local control agency officials do not want to depend upon fee revenues for a variety of reasons (cost, lack of flexibility, high administrative costs and inappropriate source of revenue), even though they may occasionally be a means to an end. That is, fees appear to be less attractive as a revenue source for pollution control programs than we thought at the beginning of this study.

OPTION 2 - TECHNICAL ASSISTANCE

Under this option EPA would undertake a program of encouraging the use of fees as a source of control agency revenue. However, OMB and EPA would clearly and forcefully express the intent of the Executive Branch to: 1 continue State and local control program grants, 2) continue current efforts to make more effective use of these grants, and 3) maintain at least the current level of grant support.

The program of encouraging the use of fees would include the following activities:

- Distributing available information about successful fee systems to State and local officials, and others.
- Preparing a workshop on the practical problems of implementation that would be made available on a voluntary basis to State officials and legislators through interested associations of State and local elected officials and control agency officials.
- Providing encouragement of the idea by Regional Administrators among State legislators, Governor's offices, and control agency officials.
- Offering technical assistance on a voluntary basis to interested control agencies through EPA Regional offices.
- Tracking trends in the sources of non-Federal revenue through the Agency's control agency grant mechanisms.
- Reporting commitment and achievements via the Agency's MBO system.

The arguments for this option may be stated as follows:

- It might encourage a few State and local governments to initiate or increase fee revenues.

- Federal encouragement of fees may be palatable to some States and localities if they are pursued as a supplement to, not a substitute for, federal grants.

- Control agency grants would be retained as a tool to be used in forging an effective Federal/State partnership and moving towards the attainment of statutory environmental goals.

The major arguments against this course of action are:

- An attempt to encourage fees at this time, even as a supplemental source of control agency income, would be viewed with distrust and would continue the current state of uncertainty regarding the Federal commitment to an effective Federal/State partnership and the attainment of statutory environmental goals.

- As States and localities are very cautious about undertaking Federally-required activities until a continuing level of Federal financial support is guaranteed, it is likely that many States would not enter into, or would withdraw from, participation in such activities as taking over the administration of the construction grant and permit programs as long as this uncertainty exists.

- The Agency, which knows very little about the problems of State and local revenue collection, runs the risk of being accused of meddling by control agency officials, who strongly prefer to rely on appropriations rather than fees.

OPTION 3 - FINANCIAL INCENTIVES

As in Option 2, EPA and OMB would clearly state the intention of the Executive Branch to 1) continue State and local control agency grants, 2) continue current efforts to make more effective use of these grants, and 3) maintain at least the current level of grant support. In lieu of offering technical assistance as proposed in Option 2, financial incentives would be made available for the increased use of fees as a supplemental source of control agency revenue. Incentive grants would be provided to defray the costs of developing and implementing new or revised fee programs, and for continuing to collect fee revenues. To be credible, these incentives should be provided out of new funds which would be an increase over and above a State's normal grant allocation. New statutory authority would be required in order for the Agency to expend funds for this purpose.

The arguments for this option may be stated as follows:

- Federal funding of a portion of a fee program's administrative costs would alleviate one of the reservations that control agency officials have about fees as a source of revenue. (i.e., the high cost of administering fee programs relative to other sources of revenue).

- Financial incentives have often proved to be more effective in bringing about change than other types of Federal encouragement.

- Federal encouragement of fees through financial incentives may be seen as less manipulative than other forms of encouragement, and hence more palatable to the States and localities.

The arguments against this course of action are:

- It is questionable whether Congress would grant the necessary statutory authority to create what is, in essence, a new, narrow categorical grant program.

- It is questionable whether such an effort will establish a desirable Federal precedent; would DOT subsequently be asked to defray the costs of administering State fee programs related to automobile safety inspection programs?

- Federal funds would be tied up for purposes that, at least in the short-term, are non-productive (i.e., it is highly likely that it would cost more to raise a dollar through fees than through general taxes; Federal funds will be used to defray these higher costs). Such revenue would fall within the scope of the Grant-Related Income provisions of OMB Circular No. A-102 and hence, in most cases, would result in reducing a State or locality's basic grant support.

- We cannot overemphasize the point that any attempt to encourage fees at this time will be viewed with distrust by the States and localities; that the uncertainty regarding the Federal commitment to an effective Federal/State partnership and the attainment of statutory environmental goals will continue; and that, as a result, States and localities would hesitate to undertake new "Federally-required activities" and to assume increasing responsibilities for the attainment of national environmental objectives.

OPTION 4 - CONTINUE CURRENT PROGRAM

This option is similar to Option 2 and 3 in that EPA and OMB would clearly state the intention of the Executive Branch to: 1) continue State and local control agency grants, 2) continue current efforts to make more effective use of these grants, and 3) maintain at least the current level of grant support. However, OMB and EPA would announce that, while our study has shown that fees might be a desirable source of control agency revenue in individual States and localities, the choice of revenue source is basically a matter for State and local resolution, and hence the Federal government should not single out any one of the alternatives available for special encouragement.

The major arguments for this course of action is:

- It has the greatest potential for dispelling the current uncertainty regarding the commitment to a Federal/State partnership and the attainment of statutory environmental goals, and for ensuring State and local willingness to undertake increasing responsibilities for the attainment of national environmental objectives.

The major argument against this course of action is:

- In the short term, it has the least potential for establishing fees as a basis for eventual State and local self-sufficiency. However, the findings of the study indicate that this potential is extremely small at present.

RECOMMENDATION

We recommend that EPA and OMB pursue Option 4 - Continue Current Program.

We believe that four factors are critical in choosing Option 4 over the other three. They are the effects on:

- the Nation's environmental protection programs,
- EPA's ability to shift greater responsibility to State and local governments,
- the New Federalism, and
- Federal credibility in general.

This study concludes that a phase-our of State and local control agency program grants would have a severe impact on the Nation's environmental protection programs. It would take years to rebuild State and local pollution control programs to current levels. The resulting impact on achieving the goals of the Federal Water Pollution Control Act and the Clean Air Act would be serious. Second, we believe a phase-out of grants would cause a dramatic shift of emphasis from State and local environmental programs to Federal programs, effectively destroying the current partnership which is aimed at shifting increased responsibilities to State and local governments. The effect of reversing the current trend towards greater State and local responsibilities would either require significantly increased Federal resources or a significant diminution of effort in achieving national environmental goals.

We also conclude that a phase-out of grants would have severe impacts on the New Federalism. Although categorical grant programs in theory restrict the options of general purpose State and local governments, we found absolutely no enthusiasm for fees as an alternative financing measure. Indeed, there was a strong feeling among officials of State and local government that agencies funded from fees tend to be considerably less responsive than agencies funded partially from appropriated funds and partially from Federal funds. Finally, a phase-out of grant funds would be viewed by State and local governments as a confusing and contradictory step, with a resulting impact on the overall credibility of the Federal Government. These officials emphasize that Federal grants to State and local pollution control agencies have been increasing for a number of years (the grants to water pollution control agencies doubled between 1973 and 1974). On the basis of this support, State and local governments have built up their own programs and committed themselves to coordinated action with the Federal Government. The effect of reversing this policy would signal not only a lack of commitment but also a lack of consistency.

As Options 2 and 3 do not include a phase-out of the grants, they would not have the same impact as Option 1. However, because of the uncertainty created by the exchange of letters between Mr. Ruckelshaus and Mr. Train, there would remain a widespread suspicion that the Federal Government was not committed to keeping up its

share of the Federal/State partnership. From the study we know that the States and localities would be less willing to take over programs such as permits and construction grants in the face of uncertain future Federal funding.

Taking all these factors into account, we conclude that the control agency grant program should be continued during the foreseeable future, that EPA and OMB should so state in no uncertain terms, and that the Federal Government should not formally encourage fees as a source of control agency revenue.

We believe, however, that there are a number of steps which can and should be taken to provide greater State and local latitude while still encouraging the assumption of delegated Federal responsibilities and ensuring the attainment of national environmental objectives. Our recommendations in this regard are:

1. That, with the concurrence of OMB, the findings of this study would be made known to interested State and local officials. Ideally, this announcement would coincide with a joint statement regarding the anticipated level of FY 76 grant support.

2. That efforts currently underway to review and enhance State and local participation in developing and reviewing EPA regulations and guidelines be made known.

3. That efforts currently underway to review and streamline EPA grant-related reporting requirements, and to make EPA grants less restrictive on the grantees while retaining clear and precise performance standards, be accelerated.

4. That past and present efforts to certify selected States to take over delegated Federal responsibilities be accelerated.

5. That NPA management take the steps necessary to establish and maintain improved, responsive relationships with State and local control agencies and general purpose government.

APPENDICES

Appendix A - Summaries of Control Agency Visits

Appendix B - Selected Federal Fee Experience

Appendix C - Summary of Known Fees in State Water Control Agencies

Appendix D - Summary of Known Fees in State and local Air Pollution Control Agencies